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U.S. Department of the Interior  
Office of Inspector General

## AUDIT REPORT

INVESTMENTS IN CERTIFICATES OF DEPOSIT,  
BUREAU OF INDIAN AFFAIRS

REPORT NO. 92-I-589  
MARCH 1992

This report may not be disclosed to anyone other than  
the auditee except by the Assistant Inspector General  
for Administration, Office of Inspector General,  
U.S. Department of the Interior,  
Washington, D.C. 20240

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# United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Headquarters Audits  
1550 Wilson Boulevard  
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March 17, 1992



## MEMORANDUM AUDIT REPORT

To: Assistant Secretary for Indian Affairs

From: Assistant Inspector General for Audits

Subject: Final Audit Report on Investments in Certificates of Deposit, Bureau of Indian Affairs (92-I-589)

### INTRODUCTION

This report is the second of two reports we plan to issue as a result of our audit of the investment programs of the Office of Trust Funds Management, Bureau of Indian Affairs. The first report, "Assessment of User Charges by the Office of Trust Funds Management, Bureau of Indian Affairs," was issued on February 13, 1992. The objective of this portion of the review was to determine whether the Bureau invested Indian trust funds in certificates of deposit which provided minimum risk of loss to the Government, Indian tribes, and individuals.

We concluded that although the Bureau invested Indian trust funds in certificates of deposit that did not result in any losses to tribes, the Bureau failed to minimize the risk of loss to the Government and Individual Indian Money account holders. Specifically, we found that the Bureau invested \$116 million in certificates of deposit with 77 financial institutions that failed in fiscal year 1990. As a result, the Federal Deposit Insurance Corporation had to subsidize at least \$65 million of this amount, and this cost was eventually passed on to taxpayers.

### BACKGROUND

On June 24, 1938, the United States Code (25 U.S.C. 162a) authorized the Bureau to manage tribal and individual Indian trust funds. In 1984, the Bureau created the Division of Trust Funds Management to consolidate all trust activities. On October 26, 1989, Secretarial Order Number 3137 established the Office of Trust Funds Management, which replaced the Division of Trust Funds Management, to collect, invest, and disburse trust income. As of September 1991, the Office of Trust Funds Management had investments of approximately \$2.1 billion, of which \$800 million was in certificates of deposit with at least 250 financial institutions.

Financial institutions are constantly being added and removed as investment sources. The Bureau solicited bids weekly from financial institutions before investing trust funds in certificates of deposit. In fiscal year 1990, the Bureau had approximately 700 approved financial institutions in the bidding process and earned an average yield rate of 8.7 percent on certificates of deposit.

All deposits, including accrued interest, are normally covered by some form of guarantee, such as Federal Deposit Insurance Corporation coverage. The Federal Government is the Nation's largest source of credit and underwriter of risk. The Government's largest commitment, which totals \$2.8 trillion, is to the Federal Deposit Insurance Corporation. The Office of Management and Budget estimates that between 1989 and 1993, the expected loss to the Federal Deposit Insurance Corporation will exceed \$100 billion because of failed financial institutions.

The Budget Enforcement Act of 1990 and the reforms outlined by the President in the fiscal year 1992 budget of the U.S. Government require Federal departments to employ cost-effective measures designed to reduce the Federal deficit and to minimize costs to taxpayers. The budget contains several proposals to manage the Government more effectively. These proposals include measures to improve accountability, reduce waste, employ risk management budgeting, and establish clear objectives to measure performance. Additionally, the United States Code (12 U.S.C. 24, "National Banking Laws") establishes minimum capital ratios<sup>1</sup> for judging an institution's financial condition and overall operating stability.

## SCOPE OF AUDIT

We performed our review from June 1991 through September 1991 at the Bureau's Office of Trust Funds Management, located in Albuquerque, New Mexico. This review was conducted as part of an audit to evaluate the Bureau's efforts to invest trust funds efficiently and effectively and with minimum risk of loss to the Government, Indian tribes, and Individual Indian Money account holders. To accomplish this audit, we reviewed applicable public laws, Treasury circulars, Departmental and Bureau policies and procedures, Office of Trust Funds Management files, and other related documents. We interviewed Bureau personnel in Albuquerque and in Washington, D.C., and personnel with the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Federal Home Loan Bank, and various commercial banks.

This audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary

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<sup>1</sup> Minimum capital ratios are one of the means used to judge the financial soundness of an institution cited under "The Uniform Financial Institutions Rating System," adopted by the Federal Deposit Insurance Corporation.

under the circumstances. Because of the limited scope of our audit, we did not evaluate the Bureau's system of internal controls.

We reviewed the Department's Annual Statement and Report for fiscal years 1989 and 1990, under the Federal Managers' Financial Integrity Act, to determine whether any reported weaknesses were within the objectives and scope of our audit. We determined that none of the reported weaknesses were directly related to the objectives and scope of our audit.

### **PRIOR AUDIT COVERAGE**

The Office of Inspector General has issued one audit report in the last 5 years which addressed the Bureau's investments in failed financial institutions. The report, "Selected Aspects of Indian Trust Fund Activities, Bureau of Indian Affairs" (No. 89-117), issued September 1989, contained four findings and 11 recommendations. One of the findings pertained to the Bureau not recognizing in its official accounting records \$7 million in lost principal and interest attributable to Bureau investments in 15 failed institutions that were not adequately insured. All recommendations were considered resolved, and 5 of the 11 recommendations were referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

The General Accounting Office has not issued any reports within the last 5 years specifically addressing the Bureau's investments in failed financial institutions.

### **RESULTS OF AUDIT**

Although the Bureau of Indian Affairs invested Indian trust funds in certificates of deposit that did not result in any losses to tribes or to Individual Indian Money account holders, the Bureau failed to minimize the risk of loss to the Government. The Budget Enforcement Act and reforms proposed by the President in the fiscal year 1992 budget provide guidance to Federal departments for the reduction of the Federal deficit and the minimization of costs to taxpayers. The Code of Federal Regulations, Part 12, contains financial criteria that can be used for judging the financial soundness of banks. The Bureau, however, did not have any policies to ensure that Indian trust funds were invested only in financially sound institutions or any procedures for oversight of those institutions to detect changes in their financial stability. Our audit found that the Bureau had invested \$116 million with 77 financial institutions that failed in fiscal year 1990. As a result, the Federal Deposit Insurance Corporation had to subsidize at least \$65 million of the \$116 million, and this cost was eventually passed on to taxpayers.

#### **Certificates of Deposit**

The Bureau did not have written policies and procedures to evaluate the financial stability of an institution before it was admitted to the certificate-of-deposit bid

process. The Bureau invested approximately \$800 million of trust funds in certificates of deposit by means of a weekly bid process. The Bureau's computerized system determined the actual distribution of funds to financial institutions according to the highest rates bid for the particular term (such as 30-, 60-, and 180-day) of certificates of deposit. We reviewed capital ratios<sup>2</sup> for 258 of the institutions holding certificates of deposit as of June 1991 and found that 57 of these institutions had ratios below required levels. In addition, the Bureau did not institute policies or procedures to ensure that only those institutions which continued to meet minimum capital ratios remained on the bidding list. For example, the Housatonic Bank of Ansonia, Connecticut, was admitted to the Bureau's bid process in February 1986. At that time, the bank's capital ratio was 7.28 percent; however, as of December 1990, the percentage had decreased to 1.08 percent. Nevertheless, as of June 1991, the Bureau maintained an investment balance in the Housatonic Bank of \$4 million.

### Federal Home Loan Banks

Certificates of deposit which were not invested in the bid cycle were placed with the District Federal Home Loan Bank of Dallas, Texas. Federal Home Loan Banks are owned collectively by their members, which are primarily savings and loans institutions and credit unions. From 1981 through 1988, the Bureau invested in an average of five such institutions per year that subsequently failed. Because of poor investment policies, by fiscal year 1990, the Bureau had investments in 77 financial institutions that failed. Of these 77 failed institutions, we found that 60 were members of the Federal Home Loan Bank Corporation. These 60 institutions accounted for \$92 million of the \$116 million in certificates of deposit placed in failed institutions. As of June 1991, all the Federal Home Loan Bank members in which the Bureau had invested trust funds were financially troubled and did not meet minimum capital ratios used for judging the stability of financial institutions.

Bureau officials indicated that because their deposits were protected from loss by the Federal Government, a financial institution's rate of return on an investment was given higher consideration than its financial soundness when placing funds. We found that the Bureau did not use risk management techniques to minimize the Federal deficit as proposed by the President in the fiscal year 1992 budget. Risk management techniques, as they pertain to investments, enable decision makers to obtain the highest yield possible on investments while maintaining a low risk. However, the Bureau only looked at the highest return being offered and not at whether the return outweighed the risk of loss to the Government. As a result, the Bureau's investments in institutions that subsequently failed contributed to the savings and loan crisis, resulting in a burden on the Federal taxpayer. Specifically, the taxpayer had to subsidize \$65 million of Indian trust funds through the Federal Deposit Insurance Corporation for investments in failed financial institutions.

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<sup>2</sup>According to Federal Deposit Insurance Corporation regulations, a bank with a capital ratio (equity to assets) of 5 percent or higher is considered to be financially sound.

Furthermore, we found that the Bureau exceeded Federal Deposit Insurance Corporation coverage by \$39.4 million on certificates of deposit invested on behalf of Individual Indian Money Account holders in 29 financial institutions. Federal Deposit Insurance regulations governing insurance coverage of custodial deposits invested in failed institutions require that trustees, such as the Bureau, or financial institutions where deposits are invested maintain accurate and unambiguous records on each owner's share in any one account to exceed \$100,000 in coverage. Nevertheless, the Federal Deposit Insurance Corporation has reimbursed Indian deposits in failed financial institutions, even though the Bureau failed to use actual figures to justify insurance coverage. The Federal Deposit Insurance Corporation accepted the Bureau's figures at face value rather than request detailed support because the Bureau maintains over 290,000 accounts that range from \$1 to \$3 million. As a result, the Federal taxpayer may be burdened with the financial responsibility of subsidizing losses suffered by the Bureau's investments of Individual Indian Monies if any of these financial institutions fail.

### **Recommendations**

We recommend that the Assistant Secretary for Indian Affairs:

1. Establish and implement written policies and procedures that provide uniform criteria to judge the soundness of a financial institution before trust funds are invested and perform periodic reviews of financial institutions after they are admitted to the certificate-of-deposit bid process.

2. Discontinue the use of the Federal Home Loan Bank program for trust funds and seek alternative investments which would more fully ensure the safety of investments and reduce the risk of loss to the U.S. Government and Individual Indian Money account holders.

### **Office of Inspector General Comments**

A discussion draft was presented to the Director, Office of Trust Funds Management, and to the Deputy Assistant Secretary for Indian Affairs on October 24, 1991, in Albuquerque. The findings and recommendations contained in this report have been modified accordingly based on the Director's response to the discussion draft.

The Deputy Commissioner of Indian Affairs did not provide a written response to our December 6, 1991, draft report. Therefore, all the recommendations are unresolved.

In accordance with the Departmental Manual (360 DM 5.3), please provide us with your written comments to this report by May 20, 1992. Your response should provide the information requested in the Appendix.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

A handwritten signature in cursive script, appearing to read "Harold Bloom".

Harold Bloom

## APPENDIX

### STATUS OF AUDIT REPORT RECOMMENDATIONS

<b>Finding/Recommendation <u>Reference</u></b>	<b><u>Status</u></b>	<b><u>Action Required</u></b>
1 and 2	Unresolved.	Provide a response to each recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide a plan identifying actions to be taken, target dates for implementation, and titles of officials responsible for implementation.